As regards this second submission by the defence, the Official Assignee relies on the case of *Re Chan Leong Watt*[1] and on the judgment of Hyndman Jones C.J., therein. Now, I need hardly say that, if I was satisfied that this was a Court of Appeal authority on the particular point in issue now before me, I would of course be bound by that authority, but I am of the view that the case in question cannot be regarded as a Court of Appeal decision on this particular matter. Even looking at that judgment alone, which of course has my very careful consideration, being a judgment of a Judge of the eminence he was, I think that the facts of the present case can be distinguished, and in view of the English cases cited and of the interpretation which appears to me to be the correct one to be placed upon the section, I hold that this second ground must succeed in the circumstance. I do not propose to express any opinion on the matter relating to interest and appropriations.

The motion is therefore dismissed.

Motion dismissed.

Solicitors: *Battenberg & Talma.*

Re ALKAFF SETTLEMENT; ALKAFF & ORS. v. ALKAFF & ORS.

[O. C. J. (Taylor J.) December 22, 1954]

[Singapore — Originating Summons No. 249 of 1953]

Will and Trust — Settlement — Payment of income to successive life tenants — Estate Duty Ordinance (Cap. 227) — Liability for estate duty — Practice — Interest on estate duty — Whether interest payable out of corpus of settled properties or income — Costs.

This was an application for decision by the Court of certain questions arising out of a settlement made in 1893 under which the income of the settled properties was to be paid for a period approximating to the longest permissible under the rule against perpetuities, to the sons of certain persons for life and after their respective deaths to their respective sons for their life-times and so on through remoter degrees of male issue with an ultimate trust of the corpus of the settled properties in favour of other beneficiaries at the end of such period.

Under the provisions of Part IV of the Estate Duty Ordinance when the various income beneficiaries die during the period of the income trust the trustees of the settlement are accountable for estate duty upon the cessor of the various life interests. The estate duty itself is payable out of the corpus of the settled properties.

In practice the duty cannot be paid immediately on the death of a beneficiary, and under s. 26 of the Estate Duty Ordinance interest upon the amount of the duty runs at the rate of 4% per annum from the date of death until the date of the actual payment of the duty.

The trustees applied to the Court for directions as to whether they should pay such interest out of the corpus of the settled properties or out of income and as to how the burden of it should be borne as amongst the various beneficiaries under the settlement.

Held: (1) no part of the interest so paid should be borne by the income beneficiaries other than those succeeding to the share of the deceased beneficiary in respect of whose death the duty and interest becomes payable; (2) in cases where the estate duty is paid by the trustees within the period of one year from the date of death of the beneficiary in question the whole amount of the interest upon it should be paid out of the income of the settled properties and recouped from the income under the settlement of the persons succeeding to the share of the deceased beneficiary; (3) where the duty has not been paid within one year from the date of the death of the deceased beneficiary in question, the same principles as in (2) above should ordinarily apply, but special circumstances might arise which would render it impracticable or inequitable for this course to be followed and each such case would have to be considered on its own merits, as necessary. Re Syed Hashim[3] not followed.

Under the terms of the settlement the trustees were directed to pay "all expenses of and incidental to . . . the execution of the Trusts of the Settlement" out of the income of the settlement. On the question as to whether the costs of these proceedings should be in the circumstances paid out of corpus or income, —

Held: although as a general rule such costs would be ordered to be paid out of corpus, in this case, in view of the words of the settlement above referred to, the costs should be paid out of income. Syed Omar Alkaff v. Syed Abdulrahman Alkaff[4] followed.

Cases referred to:—

(1) *Howe v. Kingscote* (1903) 2 Ch. 67.

(2) *Alcock v. Sutcliffe* (1847) 17 L.J.Q.B. 120.

(3) *Re Syed Hashim* (1936) M.L.J. 245; (1936) S.S.L.R. 152.

(4) *Syed Omar Alkaff v. Syed Abdulrahman Alkaff* (1946) M.L.J. 63.

ORIGINATING SUMMONS.

T. E. Atkinson for the plaintiffs.

K. Gould for the 1st defendant.

J. K. Gale for the 2nd defendant.

Cur. Adv. Vult.

Taylor J.: — This is an application for decision by the Court of certain questions arising out of a settlement made in 1893.

The family are Hadramaut Arabs and, of course, Moslems. Their interests are in owning, developing and managing town lands. The settlor conveyed property to trustees, on trust to pay the income, derived mainly from rents, to the descendants, in the male line, of himself and his brother for a period approximating to the longest permissible under the rule against perpetuities and then to distribute the corpus among the surviving grandsons of the settlor and his brother. Each left grandsons, some of whom have died and have been succeeded by great-grandsons who now share the income but can never share the corpus. Hence it is of the utmost importance that the trustees should observe, as strictly as practicable, the distinction between income and capital liabilities.

There are now more than fifty beneficiaries, some of whom are infants, but representation orders have been made so that all classes of persons interested under the deed are before the Court.

[His Lordship then dealt with matters which are not relevant to this report and continued:]

The first question is how ought these trustees to deal with the interest payable to the Treasury on estate duty in respect of deaths since 1929. As the question may arise in a variety of circumstances it is desirable to ascertain the underlying principles before examining particular instances.

I think the principles are most easily appreciated by considering a very simple case. Say a man leaves the whole of his property to his wife for life and then to his only son absolutely, that the estate consists of one house valued at $100,000 yielding $5,000 per annum and that the estate duty is $10,000 carrying 5%. On the day following the death the executor has one asset, the house, one liability, $10,000, a future income of $5,000 a year but no cash.

In theory he should forthwith sell the house for $100,000 pay the duty and buy for $90,000 another house, yielding about $4,500 per annum. The widow would then have an income of $4,500 which is the true income of the estate and the son would eventually inherit an asset worth $90,000 which is the true amount of the corpus devised to him. In practice, of course, it would be impossible to buy, immediately a house which fitted the requirements and the costs of the sale and purchase would be a dead loss to the estate as a whole, out of all proportion to the liability of $10,000 which is the sole problem.

If the executor allowed the matter to stand over for a year he would have $5,000 in cash, being accrued income and a liability of $10,500 for duty and interest. If he then paid the Treasury $5,000 on account they would postpone the balance. On this basis he could pay off the duty, with further interest, in about 2¼ years but meanwhile the widow would starve.

The executor might arrange to pay the duty by instalments, spread over 5 or 10 years, which would preserve the house intact, but this is open to three objections. Interest would continue to accrue on the outstanding balance of the duty, so that the total amount paid to the Treasury would be greatly increased. The available balance of income would be insufficient for the widow. The son would eventually receive the whole of the estate, free of duty, instead of the true corpus. In short this scheme would shift the whole burden of estate duty, which is, in the main, a capital liability, from the corpus to the income.

Another way would be to mortgage the house for $10,000 and pay off the Treasury. There might be a small saving if the mortgage interest were less than the estate duty rate but that would be off-set by the costs of the mortgage. Say the mortgage was for $12,000 at 5% or $600 per annum. If this were paid from income there would be $4,400 for the widow and when she eventually died the son could sell the house, pay off the mortgage and recover about $88,000 against the $90,000 at which the corpus actually devolving on him was valued. This approximates to the correct result but it will be noted that both the life tenant and the remainderman lose by it, even on the favourable rates assumed.

There is a possible refinement of the last scheme. The executor might pay $4,500 to the widow, $500 towards the mortgage interest and add $100 per annum, the balance of the mortgage interest, to the mortgage debt. It would, of course, accumulate at compound interest, perhaps for 30 years and eventually the son's asset would fall to about $84,000. This variation shifts the whole cost of the postponement to the remainderman.

In theory, at least, there is a refinement in the other direction. The executor might borrow $10,000, repayable on the death of the widow, on the security of the house, and pay both the costs and the interest on the advance out of income. It would be difficult to arrange this, except at high rates. Such a scheme would shift the whole cost of the postponement to the life tenant.

In practice, of course, the problem is often solved by extraneous considerations. For instance, the widow might agree to pay the mortgage interest and costs because she wanted to live in the house. That would secure the remainderman and all parties would be content but where infants are involved a trustee requires to know what the true rule is.

The simplest practical example is probably the case where neither beneficiary wishes to retain the house. Say the executor is able to complete the sale a year after the death. He then has: — *Assets*, $100,000 in cash plus $5,000 being income for the year and *Liabilities*, $10,000 for estate duty plus $500 for interest thereon. Manifestly he should pay off the duty, reinvest $90,000 and pay $4,500 to the widow. The gross income for the year, $5,000, accrued because the house remained unsold. The $500 for interest is the price of the time required to effect the sale and is a proper charge on that income. The future income will be the actual yield of the new investment of $90,000.

These examples illustrate, and in my opinion establish the following propositions.

Estate duty itself is a capital liability, chargeable to corpus. Interest on the duty is *prima facie*, chargeable to income.

By various adjustments the burden can be shifted, either wholly or in part, from corpus to income or from income to corpus.

Interest accrues, at least for a short period in every case. Therefore there must be an adjustment in every case where corpus and income devolve on different persons, as they do under this trust.

Whenever payment is in fact delayed there must be an appreciable charge for interest which is in the first place a loss to the estate as a whole and must ultimately be borne by some or all of the beneficiaries.

The periods for which interest in fact accrues are infinitely variable but the cases fall into five main classes viz :—

A. Those where administration is expeditious and the duty is paid soon after the death,
B. Those where the persons responsible for payment are dilatory,
C. Those where the complicated nature of the estate imposes unavoidable delay,
D. Those where realisation and payment are deliberately postponed, in the interests of the estate as a whole, and
E. Those where payment is postponed in the interests of particular beneficiaries.

Case A presents no difficulty. The amount of interest is small and it is deducted from the devolved income.

Case B would depend on its own facts and no instance has been stated.

In case D, the cost of the postponement must obviously be borne by the estate as a whole, and distributed among the various classes of beneficiaries in proportion to their respective interests. The principle is simple but its application to a case under this settlement might well be complicated and difficult.

In case E, the loss must be borne by those who benefit by the postponement. This will rarely occur under this trust.

The immediate difficulty is under case C. In order to appreciate this it is necessary to take a more complicated example. Assume that a testator had one son, that his wife died and he then married a woman no older than his son and they had one daughter and that he left the house to his executors, on trust to pay the income to his widow for life, then to the daughter for life and then for the son absolutely. Assume also that the widow had a substantial separate estate. Such a case approximates to some of those arising under this trust. Taking the same figures as before, the widow had a life income of about $4,500 per annum. On her death the whole income, subject to estate duty, devolved on the daughter. Neither widow nor daughter had any share in the corpus which ultimately devolves on the son — if he survives them both. In the natural course of events at least one of them would survive him. However we will assume that in the particular event the widow lived for 10 years and her daughter for a further 20 years and that after 30 years the gift to the son took effect.

On the death of the widow the estate duty, owing to aggregation, was at a high rate. The proportion of duty which was a liability of the trustee was far more than he could possibly pay out of the devolved income. Say it was $20,000. He therefore sold the investment of $90,000 and reinvested $70,000 which produced about $3,500 per annum for the daughter. On her death the process was repeated and the son ultimately received only $50,000 instead of the $100,000 at which the devise to him was originally valued. He may appreciate that the devise was subject to duty on his father's estate but he still expected $90,000. He did not participate in any way in the estates of his step mother and sister; it is not obvious that he should be charged with the duty on them and he may feel that his affairs have been mismanaged by the trustee. This is the idea underlying some of the arguments submitted on behalf of the corpus beneficiaries.

The fallacy lies in the assumption that income can be divorced from capital. It cannot. They are separate entities for some purposes but they are indissolubly related. If you wish to bequeath an income to your widow you must provide a capital asset as the source of that income. Ostensibly, our hypothetical testator made a deferred gift of the whole available corpus to his son but in truth he left his son practically nothing. If the house had been mortgaged to a stranger for $50,000 and left to the son outright it would have been a gift not of $100,000, subject to estate duty, but of $50,000, subject to duty. The intervening gifts of income had a comparable result. The gift to the widow was not a gift of income only — it was a gift of income secured by an equitable charge over the corpus that is, a gift of income plus a gift of capital charge. On the death of the widow the income and a similar capital charged devolved on the daughter. The devolution of the capital asset is the true basis of the levy of estate duty which is a statutory capital charge.

Where a legal interest devolves, the Crown is in the position of a legal mortgagee who exercises his power of sale, recovers the mortgage debt with interest

to date and pays the balance to the mortgagor's heir. When an equitable interest devolves, the Crown is in the position of an equitable mortgagee who enforces analogous rights.

The true answer to the disgruntled son in the example is that his father did not, in substance, leave him a house worth $90,000. He left to him only the residual value of a house subject to a series of encumbrances.

The effect of the settlement now in question is comparable to that of a series of wills such as the one in the example. The property is tied up for about a century to secure a series of life incomes with an ultimate gift over. Every income beneficiary necessarily has also an equitable charge over the corpus which is a capital asset and is taxed as such. On every death the Crown takes a capital sum. The corpus must shrink because the whole of the income is distributed as it accrues and there is therefore no source from which the depletions of corpus can be replenished (apart from the possible effect of accumulations during infancy which is a separate question). The corpus may indeed expand in terms of money, for various reasons not relevant to these proceedings, but the actual quantity of land and houses must diminish as one asset after another is sold to pay off levies of estate duty. This is not to say that every such claim falls wholly on the general corpus. The problem of adjustment remains. The immediate question is who should bear the burden of interest on the duty where delay is due to causes extraneous to the trust.

In my opinion this burden must fall wholly on the successors to the devolved interest. No reason has been suggested why it should fall on anyone else. If the settlor had not made this settlement and his sons had inherited the estate absolutely in equal shares, and his grandsons had inherited in equal sub-shares, intervening dealings would inevitably have led to marked inequalities between the actual sums devolving on different grandsons. No one would suggest that any such inequality should be levelled out, except perhaps by voluntary adjustment between individuals for reasons of family affection. In law and equity each grandson would have to take his own inheritance as it came, subject to whatever encumbrances it might carry. The same principle applies to these stirpital distributions of trust income. The burden of taxation must lie where it falls because there is no good reason for shifting it. This, of course, is subject always to the duty of the trustees to pay the duty in every case, as promptly as possible, so as to keep down interest, for the benefit of the family as a whole.

In the course of the argument it was submitted that where the deceased had a substantial separate estate the trustees of this settlement cannot make a deposit, on account of estate duty, with the Collector, or even reserve a suitable sum in their own accounts because they do not know, and cannot ascertain, the applicable rate. In my opinion this argument is exaggerated. I entirely agree that where the deceased was domiciled in Singapore but had extensive property elsewhere (which might easily occur) the rate is not readily ascertainable but even in that extreme case the facts remain that all the beneficiaries are members of one family. They know a good deal about one another and the trustees ought to take full advantage of the remedy provided by Section 43 of the Ordinance. In any case they have access to information which would enable them to judge whether the aggregate of the estate is likely to be in the order of half a million or a million or five million. That would suffice to fix the rate within one or two per cent and they could, within a year of the death, make in their own accounts a provisional reserve for estate duty of a percentage of the value of the share of the deceased and reduce proportionately the share of income distributable to the successors. Where the amount, roughly estimated in that way, is large and several years elapse before final ascertainment they could build up a fund for estate duty in a similar manner to the accumulation of the surplus income of an infant. It is true that the fund would not approximate closely to the amount finally required, and might exceed it; in any event adjustments would be necessary. Nevertheless this method would prevent gross over payment of income; it would keep the amounts to be adjusted within comparatively narrow limits and it would greatly mitigate hardship to the succeeding income beneficiaries.

The general answer to the question of interest is therefore that normal interest falls on the devolved income and that it is the duty of the trustees to prevent abnormal interest from accruing. As to what is meant by "normal" I would apply the principle of the "executor's year" and say that interest for a period up to one year is a normal income charge. Interest for the second and any subsequent year after the death should be regarded as an abnormal liability.

The question stated in the Summons really raises two separate and distinct questions. First, how are the trustees to adjust present and future cases; I have already dealt with that. Secondly how are they to adjust the accounts where interest has already been allowed to accrue for several years. This is more difficult.

In the first place I would rule that no part of it ought to fall on those income beneficiaries who are unconnected with the devolution — that is, the other stirpes, or sub-stirpes.

In theory, no part of such interest ought to fall on corpus but in practice this may not be wholly avoidable because the corpus is liable by statute. On principle interest is an income liability and should fall on the devolved income only but where the rate is high, owing to aggregation, and interest has been allowed to accrue for several years, the amount may be more than the devolved income can bear. The statements of Counsel suggested that this situation has arisen but no particulars were given. The summons is drawn in general terms, with a view to obtaining the directions of the Court. I have expounded the principles which I consider to be applicable and it is not possible to go further on the materials adduced. If therefore the parties still find difficulty in adjusting any pending cases they must state the facts and make a specific application for more detailed directions.

So far, I have dealt with these questions on the deed without direct reference to the numerous cases cited. I do not think it is necessary to discuss them all because many deal with the position of the life tenant of an English settled estate, which differs in some respects from that of these trustees, and it does not appear that there is any case exactly in point. I think that my decisions accord with the general trend and in particular with the judgments in *Howe v. Kingscote*[1].

One local case requires examination. I would first record my considered opinion that a local case ought not to be preferred merely because it is local. All short cuts are dangerous. If the authorities are opposed it is necessary to decide the point on principle, *Alcock v. Sutcliffe*[2].

Dispositions similar to those of this deed occurred in *Re Syed Hashim*[3], and it was held that the estate duty itself fell on the devolved corpus; the Court went on to consider separately the question of the interest on the duty. Payment of the duty had been delayed and it was found as a fact that the delay was not due to any negligence of the trustees. Meantime the successors to the devolved share of income had received income in excess of that which rightly accrued to them. It was held that they must refund the excess.

It seems that the facts were not fully before the Court, because the learned Judge was uncertain whether that excess would be greatef or less than the amount of the interest payable to the Treasury. He directed that the surplus or deficiency (as the case might be) should accrue or be charged to the devolved share of corpus but he did not indicate any reason for this part of his decision. Strictly speaking it is not the decision in any case but only the ratio decidendi which may be binding as a precedent. Moreover *Howe v. Kingscote*[1], *supra*, was not cited.

Speaking at large it could easily happen that the yield of a particular asset exceeded 6% in which case a surplus would result but that position could not occur in the present case where the yield is deemed to be 5%. If a surplus did result it would be a surplus of income over and above the amount of the Treasury interest chargeable to that income; yet that available income was to be taken away from the income beneficiaries to become a windfall for the corpus beneficiaries. In the alternative event there would be a deficiency, which was a loss to the estate, for which the trustees were not responsible and which must therefore fall either on corpus or on income or be distributed. The income beneficiaries were not responsible for the delay, but it is not suggested that the successors to the devolved corpus were responsible for it so why should one group bear the loss rather than the other? The truth is that the learned Judge never decided whether the interest in question, which was in part abnormal, ought to fall on corpus or on income and the case is not an authority on that particular question.

[His Lordship further dealt with matters which are not relevant to this report and continued:]

In general the costs of litigation such as this are charged to corpus but in previous proceedings for construction of this same deed of settlement Pedlow J. held that such costs fairly come within the meaning of the words "all expenses of the execution of the trusts of these presents" and accordingly directed that the costs should be paid from income; at first instance, the costs of all parties were allowed as between Solicitor and Client. On these points the Order was affirmed by the Privy Council in *Syed Omar Alkaff v. Syed Abdulrahman Alkaff*[4]. Counsel for all parties agreed that these precedents were applicable to the costs of this Summons and with the approval of the trial Judge the Order was drawn accordingly.

Order accordingly.

Solicitors: *Allen & Gledhill; Rodyk & Davidson; Sisson & Delay*